



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

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John G. Morgan
Comptroller


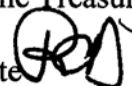


April 28, 2005

Memorandum

TO: The Honorable Phil Bredesen
Governor

The Honorable Douglas Henry, Jr., Chairman
Senate Finance, Ways, & Means Committee

The Honorable Craig Fitzhugh, Chairman
House Finance, Ways, & Means Committee

FROM: John Morgan, Comptroller of the Treasury 
Riley Darnell, Secretary of State 
Dale Sims, State Treasurer 
M.D. Goetz, Jr., Commissioner
Department of Finance & Administration 

SUBJECT: Revenue Estimates for FY 2004-05 and FY 2005-06

The State Funding Board met on April 26 and 28, 2005 to hear updated presentations on, and to engage in discussions about, the State's near-term economic outlook for the fiscal years 2004-05 and 2005-06. During this meeting, the Board heard economic testimony from Dr. William Fox of The University of Tennessee's Center for Business and Economic Research, Mr. Jim White of the Fiscal Review Committee, and Mr. Reid Linn of the State Department of Revenue. The Board was also briefed on the monthly revenue report on state tax collections for the month of March. The state tax revenue estimates provided by each of the presenters are summarized in the two attachments to this memorandum (schedule 1 for fiscal year 2004-05 and schedule 2 for fiscal year 2005-06).

The consensus is that the national economy is growing moderately. Dragging the economy is the federal deficit which is growing in large part due to the continued federal expenditures on war and foreign conflict. Potential continued moderate growth in the economy will be impacted by high energy prices, the trade deficit (massively larger than experienced previously), and interest rate increases.

Tennessee's overall growth in revenue is slow. Only seven states have experienced lower growth in revenue than Tennessee. Tennessee's sales tax performance is not where it should be, it is weak relative to its own history. Only thirteen states have slower growth in sales tax than Tennessee. Five states do not collect sales tax. Growth in sales tax collections in Tennessee can be attributed to sales of building materials, related to housing, a sector heavily influenced by interest rate changes. If the price of oil remains above \$50 per barrel, the State could experience a loss of \$50 million in sales tax. Franchise and excise tax is showing a net positive growth. Of the last 9 quarters, there have been 8 quarters of growth in corporate income taxes. However, profit growth is expected to be slower next year. Tennessee is currently performing worse in job growth and experiencing a higher unemployment rate when compared with the rest of the nation. The information sector (publishing and printing) is performing poorly in Tennessee.

Based on the testimony received and the Board discussions, the Board determined to revise the consensus revenue ranges for fiscal year 2004-05 and for fiscal year 2005-06, established in December 2004. The following table summarizes these revised estimates:

	<u>FY 2004-05</u>		<u>FY 2005-06</u>	
	<u>Low</u>	<u>High</u>	<u>Low</u>	<u>High</u>
Total State Taxes	4.1%	4.5%	3.7%	3.9%
General Fund Only	4.25%	4.8%	3.95%	4.2%

The Board believes these consensus revenue growth ranges to be reasonable and appropriate for use in state budgeting.

Additionally, the State Funding Board received presentations regarding the Tennessee Education Lottery. Legislation in 2003 created the Tennessee Education Lottery Corporation (Tennessee Code Annotated Sections 4-51-101 et seq.) Tennessee Code Annotated Section 4-51-111(c) requires the State Funding Board to establish a projected revenue range for the net lottery proceeds for the remainder of the current fiscal year and for the succeeding fiscal year. In December 2004, Mr. White, Executive Director, and Mr. Robert Currey, Fiscal Analyst, with the Fiscal Review Committee presented the Board their projections for the Tennessee Education Lottery. Additionally, Ms. Rebecca Paul, the Chief Executive Officer and President of the Tennessee Education

Lottery Corporation, Mr. Andy Davis, Chief Financial and Technology Officer and Mr. Steve Adams, the Chief Operating Officer, presented their projections.

At the April 26, 2005 meeting, the State Funding Board received a presentation from Ms. Paul, Mr. Davis, and Mr. Adams were also present. They discussed jackpot fatigue in relation to Powerball ticket sales, potential cannibalism of CASH3 sales by CASH4 (introduced on April 17, 2005), and impact of gasoline prices on discretionary spending (and purchase of instant game tickets).

Ms. Paul then presented estimates, qualified as being conservative, of \$217.51 to \$223.53 million for fiscal year 2004-05 and of \$226.21 to \$232.47 million for fiscal year 2005-06 for the net proceeds of lottery. She stated that they used a return of 28.6% and 29% for each of the fiscal years.

Mr. White, Executive Director, and Mr. Robert Currey, Fiscal Analyst, with the Fiscal Review Committee presented Fiscal Review's projections. In developing its estimates, Fiscal Review excluded the data from the initial weeks after implementation of games. For fiscal year 2005-06, Fiscal Review used fiscal year 2004-05 estimates as the base year, projected a 4% sales growth rate, a 1% population growth rate, and held expenses as a percent of revenue constant. They concluded that their December estimates are still reasonable. Although the Net Revenue estimates are low, the expenses are higher (more instant ticket sales require more prize payouts). They presented estimates of \$212.3 to 233 million for fiscal year 2004-05 and of \$223 to 244.8 million for fiscal year 2005-06 for the net proceeds of the lottery; the weighted average estimate of net proceeds for fiscal year 2004-05 is \$221,600,000 and for fiscal year 2005-06 is \$232,800,000. These amounts reflect a return of 31% and 30% for each of the fiscal years.

Consensus was reached on the following revised estimates of the range for net proceeds of lottery revenues to be deposited in the Lottery for Education Account, to be used for the various statutory purposes:

NET LOTTERY PROCEEDS		
	<u>Low</u>	<u>High</u>
<u>FY 2004-05</u>	\$217,000,000	\$224,000,000
<u>FY 2005-06</u>	\$226,000,000	\$233,000,000

Each of us stands ready to discuss this further at your convenience.

Schedules (2)
Attachment

cc. The Honorable John S. Wilder
The Honorable Jimmy Naifeh

**COMPARISON OF ESTIMATED STATE TAX REVENUE FOR
FISCAL YEAR 2004-2005**

Schedule 1

(Accrual - Basis Estimates)

2004-2005

DEPARTMENT OF REVENUE	2003-2004	% CHANGE		2005-06	% CHANGE		% CHANGE		% CHANGE	
	ACTUAL	BUDGETED	OVER 03-04	BUDGET DOCUMENT	OVER 03-04	DR. FOX	OVER 03-04	FISCAL REVIEW	OVER 03-04	
SOURCE OF REVENUE	ACCRUAL	ESTIMATE	ACTUAL	ESTIMATE	ACTUAL	ESTIMATE	ACTUAL	ESTIMATE	ACTUAL	
Sales and use Tax	\$ 5,810,784,300	\$6,096,600,000	4.92%	\$ 6,031,600,000	3.80%	\$6,057,000,000	4.24%	\$6,078,080,000	4.60%	
Gasoline Tax	599,326,500	617,600,000	3.05%	610,000,000	1.78%	599,300,000	0.00%	599,327,000	0.00%	
Motor Fuel Tax	167,731,000	171,600,000	2.31%	171,600,000	2.31%	169,000,000	0.76%	169,408,000	1.00%	
Gasoline Inspection Tax	62,377,500	63,700,000	2.12%	63,700,000	2.12%	63,500,000	1.80%	63,438,000	1.70%	
Motor Vehicle Registration Tax	238,486,700	244,100,000	2.35%	245,100,000	2.77%	252,000,000	5.67%	244,449,000	2.50%	
Income Tax	139,991,600	141,800,000	1.29%	145,600,000	4.01%	153,000,000	9.29%	155,000,000	10.72%	
Privilege Tax - Less Earmarked Portion	246,086,300	255,000,000	3.62%	250,700,000	1.87%	251,000,000	2.00%	253,469,000	3.00%	
Gross Receipts Tax - TVA	202,743,400	204,400,000	0.82%	216,200,000	6.64%	215,300,000	6.19%	213,649,000	5.38%	
Gross Receipts Tax - Other	16,385,100	23,000,000	40.37%	17,300,000	5.58%	17,200,000	4.97%	19,334,000	18.00%	
Beer Tax	17,391,200	18,100,000	4.08%	17,500,000	0.63%	17,500,000	0.63%	17,565,000	1.00%	
Alcoholic Beverage Tax	35,705,200	36,900,000	3.35%	36,900,000	3.35%	37,000,000	3.63%	36,955,000	3.50%	
Franchise & Excise Taxes	1,197,803,600	1,146,100,000	-4.32%	1,206,500,000	0.73%	1,287,000,000	7.45%	1,290,000,000	7.70%	
Inheritance and Estate Tax	90,718,400	85,000,000	-6.30%	85,000,000	-6.30%	80,000,000	-11.82%	90,000,000	-0.79%	
Tobacco Tax	119,689,000	116,000,000	-3.08%	120,900,000	1.01%	116,000,000	-3.08%	118,900,000	-0.66%	
Motor Vehicle Title Fees	11,284,000	11,300,000	0.14%	11,300,000	0.14%	11,300,000	0.14%	11,510,000	2.00%	
Mixed Drink Tax	40,769,200	42,000,000	3.02%	42,400,000	4.00%	42,400,000	4.00%	42,604,000	4.50%	
Business Tax	94,924,600	97,000,000	2.19%	98,700,000	3.98%	98,700,000	3.98%	98,800,000	4.08%	
Severance Tax	998,200	1,100,000	10.20%	1,000,000	0.18%	1,000,000	0.18%	1,300,000	30.23%	
Coin Operated Amusement Tax	784,700	1,500,000	91.16%	800,000	1.95%	800,000	1.95%	500,000	-36.28%	
TOTAL DEPARTMENT OF REVENUE	\$ 9,093,980,500	\$9,372,800,000	3.07%	\$ 9,372,800,000	3.07%	\$9,469,000,000	4.12%	\$9,504,288,000	4.51%	
GENERAL FUND ONLY (1)	\$ 7,583,572,200	\$ 7,805,000,000	2.92%	\$ 7,805,000,000	2.92%	\$7,906,700,000	4.26%	\$7,946,888,000	4.79%	
Growth over FY 05 Budgeted Estimate:										
Total					\$0	\$96,200,000		\$131,488,000		
General Fund					\$0	\$101,700,000		\$141,888,000		
Growth over FY 06 Budget Document Estimate:										
Total						\$96,200,000		\$131,488,000		
General Fund						\$101,700,000		\$141,888,000		
SELECTED TAXES	ACTUAL	BUDGETED	%	BUDGET DOC.	%	DR. FOX	%	FISCAL REVIEW	%	
SALES AND USE TAX	\$ 5,810,784,300	\$6,096,600,000	4.92%	\$ 6,031,600,000	3.80%	\$6,057,000,000	4.24%	\$6,078,080,000	4.60%	
FRANCHISE AND EXCISE TAXES	1,197,803,600	1,146,100,000	-4.32%	1,206,500,000	0.73%	1,287,000,000	7.45%	1,290,000,000	7.70%	
INCOME TAX	139,991,600	141,800,000	1.29%	145,600,000	4.01%	153,000,000	9.29%	155,000,000	10.72%	
ALL OTHER TAXES	1,945,401,000	1,988,300,000	2.21%	1,989,100,000	2.25%	1,972,000,000	1.37%	1,981,208,000	1.84%	

(1) F&A calculated the General Fund distribution for all presenters.

**COMPARISON OF ESTIMATED STATE TAX REVENUE FOR
FISCAL YEAR 2005-2006**

Schedule 2

(Accrual - Basis Estimates)

2005-2006						
DEPARTMENT OF REVENUE	2005-06	% CHANGE		% CHANGE		% CHANGE
SOURCE OF REVENUE	BUDGET DOCUMENT	OVER 04-05	DR. FOX	OVER 04-05	FISCAL REVIEW	OVER 04-05
	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE	ESTIMATE
Sales and use Tax	\$ 6,303,000,000	4.50%	\$ 6,329,600,000	4.50%	\$ 6,357,672,000	4.60%
Gasoline Tax	616,100,000	1.00%	600,000,000	0.12%	599,327,000	0.00%
Motor Fuel Tax	176,700,000	2.97%	174,100,000	3.02%	173,643,000	2.50%
Gasoline Inspection Tax	65,000,000	2.04%	64,800,000	2.05%	64,707,000	2.00%
Motor Vehicle Registration Tax	252,000,000	2.82%	257,000,000	1.98%	251,782,000	3.00%
Income Tax	152,900,000	5.01%	162,200,000	6.01%	161,200,000	4.00%
Privilege Tax - Less Earmarked Portion	263,200,000	4.99%	263,600,000	5.02%	264,875,000	4.50%
Gross Receipts Tax - TVA	219,600,000	1.57%	220,500,000	2.42%	217,922,000	2.00%
Gross Receipts Tax - Other	18,200,000	5.20%	18,100,000	5.23%	20,107,000	4.00%
Beer Tax	17,900,000	2.29%	17,700,000	1.14%	17,881,000	1.80%
Alcoholic Beverage Tax	37,600,000	1.90%	37,400,000	1.08%	37,879,000	2.50%
Franchise & Excise Taxes	1,234,600,000	2.33%	1,319,200,000	2.50%	1,335,150,000	3.50%
Inheritance and Estate Tax	89,300,000	5.06%	80,000,000	0.00%	92,700,000	3.00%
Tobacco Tax	122,100,000	0.99%	116,000,000	0.00%	120,089,000	1.00%
Motor Vehicle Title Fees	11,500,000	1.77%	11,600,000	2.65%	11,740,000	2.00%
Mixed Drink Tax	44,500,000	4.95%	44,900,000	5.90%	44,521,000	4.50%
Business Tax	102,600,000	3.95%	102,700,000	4.05%	102,554,000	3.80%
Severance Tax	1,000,000	0.00%	1,000,000	0.00%	1,300,000	0.00%
Coin Operated Amusement Tax	800,000	0.00%	800,000	0.00%	500,000	0.00%
TOTAL DEPARTMENT OF REVENUE	\$ 9,728,600,000	3.80%	\$ 9,821,200,000	3.72%	\$ 9,875,549,000	3.91%
GENERAL FUND ONLY (1)	\$ 8,115,500,000	3.98%	\$ 8,219,100,000	3.95%	\$ 8,278,849,000	4.18%

Growth over FY 06 Budget Document Estimate:

Total

\$92,600,000

\$146,949,000

General Fund

\$103,600,000

\$163,349,000

SELECTED TAXES	BUDGET DOC.	%	DR. FOX	%	FISCAL REVIEW	%
SALES AND USE TAX	\$ 6,303,000,000	4.50%	\$ 6,329,600,000	4.50%	\$ 6,357,672,000	4.60%
FRANCHISE AND EXCISE TAXES	1,234,600,000	2.33%	1,319,200,000	2.50%	1,335,150,000	3.50%
INCOME TAX	152,900,000	5.01%	162,200,000	6.01%	161,200,000	4.00%
ALL OTHER TAXES	2,038,100,000	2.46%	2,010,200,000	1.94%	2,021,527,000	2.04%

(1) F&A calculated the General Fund distribution for all presenters.